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Integration of the economies in transition into the world economy**

Report of the Secretary-General

Summary

The present report provides an overview of the progress made in the integration of the economies in transition into the world economy. It examines the challenges that they face and the progress that they have achieved. The report analyses macroeconomic developments, efforts to create a private sector, partly through privatization, and success in attracting foreign direct investment. The report also examines the external debt situation of these countries and the progress made towards trade liberalization. It notes the importance of reaching trade agreements with other economies in transition and third parties, especially the European Union.

Considerable progress has been made, often in difficult circumstances, by the economies in transition in their efforts to integrate into the world economy. However, in some economies in transition, in particular in some countries members of the Commonwealth of Independent States, progress has been arduous and international assistance is still needed to ensure that they fully participate in the world economy. Assistance is also needed to ensure the successful transition and peaceful development of countries that have emerged from conflict.

* A/57/150

** The document was submitted late to the conference services without the explanation required under paragraph 8 of General Assembly resolution 53/208 B, by which the Assembly decided that, if a report is submitted late, the reason should be included in a footnote to the document.

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I. Introduction

1. In its resolution 55/191 of 20 December 2001, the General Assembly reaffirmed the need for the full integration of the countries with economies in transition into the world economy which it had called for in previous resolutions, and noted the progress made towards achieving this goal with macroeconomic stability and structural reforms in those countries. It also recognized the difficulties faced by the countries with economies in transition in responding adequately to the challenges of globalization, the need to ensure favourable conditions for market access of exports from those countries and the important role that foreign investment should play in those countries.

2. In the same resolution, the General Assembly called upon the organizations of the United Nations system to continue to conduct analytical activities and to provide policy advice and technical assistance to the Governments of the countries with economies in transition on the social and political framework for completing market-oriented reforms with a view to sustaining the positive trends in the economic and social development of those countries. Previous reports have covered the role of the United Nations system in these fields (see A/55/188, A/53/336 and Add.1 and A/51/285).

3. The Assembly requested the Secretary-General to submit to it, for consideration at its fifty-seventh session, a report on the implementation of resolution 55/191, with particular focus on an analysis that would determine the progress achieved in the integration of the countries with economies in transition into the world economy. The present report has been prepared in response to that request.

II. Macroeconomic developments

4. After 1989, the Governments of various economies in transition decided that their economic relationships with the rest of the world would be based upon normal market principles.[1] Private economic agents would be allowed to establish their own businesses, to buy and sell to domestic and foreign customers, and to accept loans and direct investment from domestic and foreign investors. For its part, the State would withdraw from direct ownership of the means of production by handing over to private agents control of its productive assets. It would, however, be expected to build up the institutions, such as social security systems that were independent of the workplace and regulatory mechanisms and provisions to protect property rights, that assist the functioning of the market economy. A profound transformation was thus to take place in all aspects of economic life.

5. This change from a planned to a market economy was accompanied by a major recession as those industries that could not operate in a market environment were forced to contract and to shed labour. This recession was to some extent anticipated by many policy makers, since the transition from a centrally planned to a market economy could be expected to take years, with many of the benefits emerging only gradually. The speed of recovery of individual countries from this transformational recession depended on many factors, including their starting conditions, historical legacy, geographical position and proximity to important markets.

6. The first year of economic recovery in the Central and Eastern European countries as a group was 1994 (see table 1). The recovery in many of the countries of south-eastern Europe[2] was slower and often more interrupted than that in the other countries. In the Baltic countries, growth resumed in 1995, although they suffered a contraction in 1999. During the period from 1995 to 2001, their average rate of growth was 4.2 per cent.

7. The member countries of the Commonwealth of Independent States (CIS) had a longer history of central planning, and went through the break-up of a unitary state. Their recovery was more difficult. Only since 1999, with the revival of the economy of the Russian Federation, have they resumed growth. The Russian Federation has benefited from higher oil prices since 2000, policy reform and improved domestic demand. Economic growth in the region decelerated from 8.5 per cent in 2000 to 5.7 per cent in 2001. It was not until 2000 — more than one decade after the transition had begun — that the economies of all CIS member States grew simultaneously. In the meantime, gross domestic product (GDP) contracted in many of them.

8. Another indication of how the economies in transition are starting to function as normal market economies is the decline in inflation, which fell from over 800 per cent in 1993 for the whole group (the range varying from 20 per cent to nearly 5,000 per cent in individual countries) to under 15 per cent in 2001 (see table 2). In most economies in transition, inflation rates remained under 10 per cent in 2001. In 2002, inflation is expected to decline further and only four countries are expected to have inflation in excess of 20 per cent.[3]

III. Private sector development

9. In order for the countries with economies in transition to be able to integrate with the rest of the world, it was important to transform them into market economies with private control of the means of production. There are two major ways in which a private sector has been created: by the privatization of existing State-owned enterprises and by the formation of new enterprises. According to the European Bank for Reconstruction and Development, 95 per cent of new companies in economies in transition have been small-sized or medium-sized enterprises.[4] These enterprises, which usually engage in labour-intensive activities and are responsive to short-term demand changes, have played a critical role in the economies in transition that are in the process of restructuring. They show that a market economy is being created in which entrepreneurs are able to start up their own businesses. However, at the present time, they are not as crucial to the integration of these economies into the world economy as are larger enterprises. The latter have attracted most of the foreign direct investment (FDI) and are the enterprises that have so far shown the greatest capability to engage in international trade.

10. Despite occasional setbacks, most economies in transition have been successful in implementing privatization programmes and thereby helping to create a private sector. This has been an achievement of major importance. Without such progress, they would not have been classified as market economies by their trading partners, and those wishing to enter the European Union would have failed to meet one of the basic criteria for membership.

Table 1

Economies in transition: rates of growth of real gross domestic product, 1993-2002

(Annual percentage change)[a]

	1993	1994	1995	1996	1997	1998	1999	2000	2001[b]	2002[c]
Economies in transition	-6.7	-7.2	-0.6	-0.1	2.2	-0.7	3.0	6.3	4.4	3.5
Central and Eastern European and Baltic States	-1.9	3.6	5.5	4.1	3.5	2.7	1.3	3.9	2.9	2.7
Central and Eastern European States	-1.2	4.0	5.7	4.1	3.3	2.6	1.4	3.9	2.7	2.6
Albania	9.7	8.3	13.3	9.0	-7.0	8.0	7.3	7.8	6.5	6.0
Bulgaria	-1.4	1.8	2.8	-10.2	-7.0	3.5	2.4	5.8	4.0	3.4
Croatia	-8.0	5.9	6.8	5.9	6.8	2.5	-0.4	3.7	3.2	2.7
Czech Republic	0.0	2.2	6.0	4.3	-0.8	-1.2	-0.4	2.9	3.6	3.6
Hungary	-0.6	3.1	1.4	1.4	4.6	4.9	4.2	5.2	3.8	3.6
Poland	3.8	5.1	7.1	6.0	6.9	4.8	4.1	4.0	1.1	1.2
Romania	1.6	3.9	7.1	4.0	-6.1	-5.4	-3.2	1.8	5.3	3.6
Slovakia	-3.6	4.8	7.0	6.5	6.5	4.1	1.9	2.2	3.3	3.4
Slovenia	2.9	5.3	4.2	3.5	4.5	3.8	5.2	4.6	3.0	3.0
The former Yugoslav Republic of Macedonia	-9.0	-1.9	-1.2	0.7	1.5	2.9	2.7	5.1	-4.6	3.0
Yugoslavia	-30.8	2.7	6.0	5.9	7.4	2.5	-19.3	5.0	5.5	5.0
Baltic States	-14.2	-4.7	2.2	4.1	8.5	4.6	-1.7	5.4	6.3	4.1
Estonia	-9.0	-2.0	4.3	3.9	10.6	4.7	-1.1	6.4	5.4	4.0
Latvia	-14.9	0.6	-0.8	3.3	8.6	3.9	1.1	6.6	7.6	5.0
Lithuania	-16.2	-9.8	3.3	4.7	7.3	5.1	-4.2	3.9	5.9	3.5
Commonwealth of Independent States	-9.4	-13.7	-5.1	-3.5	1.0	-3.7	4.7	8.5	5.7	4.2
Armenia	-14.8	5.4	6.9	5.9	3.3	7.3	3.3	6.0	9.6	5.5
Azerbaijan	-23.1	-19.7	-11.8	1.3	5.8	10.0	7.4	11.1	9.9	8.0
Belarus	-7.6	-12.6	-10.4	2.8	11.4	8.4	3.4	5.8	4.1	2.0
Georgia	-25.4	-11.4	2.4	10.5	10.8	2.9	2.9	1.8	4.5	5.0
Kazakhstan	-9.2	-12.6	-8.2	0.5	1.7	-1.9	1.7	9.6	13.2	7.0
Kyrgyzstan	-16.0	-20.1	-5.4	-7.1	9.9	2.1	3.6	5.0	5.3	4.5
Republic of Moldova	-1.2	-31.2	-1.4	-7.8	1.3	-6.5	-4.4	1.9	6.1	3.5
Russian Federation	-8.7	-12.7	-4.1	-3.5	0.8	-4.9	5.4	9.0	5.0	4.0
Tajikistan	-11.0	-18.9	-12.5	-4.4	1.7	5.3	3.7	8.3	10.2	6.0
Turkmenistan[d]	-10.0	-17.3	-7.2	-6.7	-11.3	5.0	16.0	17.6	20.5	15.0

	1993	1994	1995	1996	1997	1998	1999	2000	2001[b]	2002[c]
Ukraine	-14.2	-23.0	-12.2	-10.0	-3.0	-1.9	-0.4	5.8	9.0	5.0
Uzbekistan	-2.3	-4.2	-0.9	1.6	2.5	4.4	4.4	4.0	4.5	2.5

Source: United Nations Secretariat, Department of Economic and Social Affairs, based on data of the Economic Commission for Europe.

[a] Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP at 1995 prices and exchange rates.

[b] Partly estimated.

[c] Forecasts, based in part on Project LINK.

[d] The reliability of figures for Turkmenistan is questionable owing to not well-documented deflation procedures.

Table 2
Economies in transition: consumer price inflation, 1993-2002
(Average annual percentage change)

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001[a]*	*2002[b]*
Economies in transition[c]	838.3	412.6	145.1	41.1	38.3	21.9	50.6	19.6	14.6	12.0
Central and Eastern European and Baltic States[c]	149.9	45.0	25.8	25.2	66.9	16.6	11.7	12.3	9.0	6.4
Central and Eastern European States[c]	146.2	44.6	25.5	25.4	69.4	17.0	12.1	12.7	9.3	6.6
Albania	85.0	21.5	8.0	12.7	33.1	20.3	-0.1	0.0	3.1	4.0
Bulgaria	72.9	96.2	62.0	121.7	1 058.3	18.7	2.6	10.2	7.3	7.9
Croatia	1 516.6	97.5	2.0	3.6	3.7	5.9	4.3	6.4	5.0	4.8
Czech Republic	20.8	10.0	9.1	8.9	8.4	10.6	2.1	3.9	4.7	3.8
Hungary	22.6	19.1	28.5	23.6	18.4	14.2	10.1	9.9	9.2	5.9
Poland	36.9	33.2	28.1	19.8	15.1	11.7	7.4	10.2	5.5	3.5
Romania	256.2	137.1	32.2	38.8	154.9	59.3	45.9	45.7	34.5	24.0
Slovakia	23.1	13.4	10.0	6.1	6.1	6.7	10.5	12.0	7.1	4.0
Slovenia	31.7	21.0	13.5	9.9	8.4	8.1	6.3	9.0	8.4	7.0
The former Yugoslav Republic of Macedonia	353.1	126.6	16.4	2.5	0.9	-1.4	-1.3	6.6	5.2	2.0
Yugoslavia	..[d]	..[d]	71.8	90.5	23.2	30.4	44.1	75.7	90.0	24.0
Baltics States	232.2	54.2	32.1	22.0	9.3	6.3	2.0	2.3	2.8	3.4
Estonia	89.6	47.9	28.9	23.1	11.1	10.6	3.5	3.9	5.8	4.5
Latvia	109.1	35.7	25.0	17.7	8.5	4.7	2.4	2.8	2.5	3.2
Lithuania	410.1	72.0	39.5	24.7	8.8	5.1	0.8	1.0	1.3	3.0
Commonwealth of Independent States	1 321.0	670.4	232.4	52.8	17.3	25.8	79.1	24.8	18.5	16.0
Armenia	3 731.8	4 964.0	175.5	18.7	13.8	8.7	0.7	-0.8	3.0	3.5
Azerbaijan	1 129.7	1 663.9	411.5	19.8	3.6	-0.8	-8.6	1.8	2.0	2.0
Belarus	1 190.9	2 219.6	709.3	52.7	63.9	73.2	293.7	168.9	61.0	50.0
Georgia	4 084.9	22 286.1	261.4	39.4	7.1	3.5	19.3	4.2	5.0	4.0
Kazakhstan	1 662.7	1 880.1	176.3	39.2	17.5	7.3	8.4	13.4	8.0	6.5
Kyrgyzstan	1 208.7	278.1	42.9	31.3	23.4	10.3	35.7	18.7	7.0	6.0
Republic of Moldova	1 751.0	486.4	29.9	23.5	11.8	7.7	39.3	31.3	10.0	10.0
Russian Federation	875.0	309.0	197.4	47.8	14.7	27.8	85.7	20.8	18.6	16.0
Tajikistan	2 884.8	350.3	682.1	422.4	85.4	43.1	27.5	32.9	37.0	10.0
Turkmenistan	3 128.4	2 719.5	1 105.3	714.0	83.7	16.8	23.5	7.0	8.2	9.0

	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]	2002[b]
Ukraine	4 734.9	891.2	376.7	80.2	15.9	10.6	22.7	28.2	12.0	11.0
Uzbekistan	1 231.8	1 910.2	304.6	54.0	58.8	17.7	29.0	24.9	26.6	25.0

Source: United Nations Secretariat, Department of Economic and Social Affairs, based on data of Economic Commission for Europe.

[a] Partly estimated.

[b] Forecasts.

[c] Yugoslavia excluded in 1993 and 1994.

[d] Annual rates of hyperinflation of over 1 trillion percentage points.

11. Measuring the success of privatization is a difficult task but, while in 1989 almost all enterprises in the economies in transition were State-owned, by mid-1997 the private sector's contribution to GDP had risen to exceed 50 per cent in 15 of the total of 27 countries in the group.[5] In mid-2001, the number of countries meeting this criterion reached 21 and in 6 of them the share was over 75 per cent (see table 3). However, an indication of how much further some countries have to go to become mature market economies is that the private sector still accounted for less than one half of GDP in six countries.[6]

Table 3
Private sector share of Gross Domestic Product, mid-2001

Share of gross domestic product (Percentage)	*Countries*
75 and over	Albania, Czech Republic, Estonia, Hungary, Poland, Slovakia
50-74.9	Armenia, Azerbaijan, Bulgaria, Croatia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Republic of Moldova, Romania, Russian Federation, Slovenia, Ukraine, the former Yugoslav Republic of Macedonia
Less than 50	Belarus, Bosnia and Herzegovina, Yugoslavia, Tajikistan, Turkmenistan, Uzbekistan

Source: European Bank for Reconstruction and Development, *Transition Report Update 2001* (London, 2001).

12. However, the share of the private sector in GDP, or in the total number of enterprises, is not always an accurate indicator of private sector development since governmental interference in the activity of private enterprises may vary significantly across countries. In some cases, a formally private enterprise may still remain effectively under State control. Using a variety of indicators, the European Bank for Reconstruction and Development has ranked economies in transition in terms of progress achieved in large-scale privatization. In 2001, none of them received the highest rating of 4+, for standards and performance typical of advanced industrial economies, although the Czech Republic, Estonia, Hungary, and Slovakia closely approached it, receiving a rating of 4 (see table 4).[6]

13. Economies in transition used a variety of privatization methods, the choice of which depended on initial economic conditions and socio-political considerations. Most methods fell into one of the following categories: management and/or employee buyouts; mass privatization; floating shares on the stock market; and direct sales. A country usually applied several approaches. Methods frequently varied by sector and the focus on a particular method occasionally changed as transition progressed. The different methods produced different results in terms of the ability of the enterprise to function as a profitable concern and interact with other enterprises, including foreign partners.

Table 4
Selected indicators of the European Bank for Reconstruction and Development on progress of transition[a]

Rating	*Large-scale privatization*[b]	*Trade and foreign exchange system*[c]
Less than 3	Albania, Azerbaijan, Belarus, Bosnia and Herzegovina, Yugoslavia, Tajikistan, Turkmenistan, Uzbekistan	Belarus, Russian Federation, Turkmenistan, Uzbekistan
Between 3 and 4	Armenia, Bulgaria, Croatia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Poland, Republic of Moldova, Romania, Russian Federation, Slovenia, Ukraine, the former Yugoslav Republic of Macedonia	Azerbaijan, Bosnia and Herzegovina, Kazakhstan, Yugoslavia, Tajikistan, Ukraine
4 and over	Czech Republic, Estonia, Hungary, Slovakia	Albania, Armenia, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kyrgyzstan, Latvia, Lithuania, Poland, Republic of Moldova, Romania, Slovakia, Slovenia, the former Yugoslav Republic of Macedonia

Source: European Bank for Reconstruction and Development, *Transition Report Update 2001* (London, 2001).

[a] The Bank's classification system is based on a 1-4+ scale; for a detailed description of this system, see European Bank for Reconstruction and Development, *Transition Report Update 2001* (London, 2001).

[b] 1 represents "Little private ownership"; 4+ represents "Standards and performance typical of advanced industrial economies: more than 75 per cent of enterprise assets in private ownership with effective corporate governance".

[c] 1 represents "Widespread import and/or export controls or very limited legitimate access to foreign exchange"; 4+ represents "Standards and performance norms of advanced industrial economies: removal of most tariff barriers; membership in the World Trade Organization".

14. The method of direct sales, if properly implemented, helps to attract strategic investors which can manage the properties efficiently and provide funds to modernize the enterprise. It can also allow Governments to collect revenues. The approach was widely used in Estonia and Hungary. Hungary began sales to foreign investors at an early stage, having already created an institutional and legal framework for the new market economy system. This early privatization resulted in deep restructuring taking place sooner than in the other three Visegrad countries — the Czech Republic, Poland and Slovakia.

15. Direct sales were also important in Kazakhstan, the Russian Federation, Slovenia and several other countries. Insufficient domestic capital for, and therefore

low domestic interest in, such purchases were among the problems associated with this approach. Foreign investors, on the other hand, were sometimes not ready to make such commitments because of poor corporate transparency.

16. Many problems remain from the period of privatization and in some countries further divestment of State assets must be accomplished before they will be able to integrate fully into the world economy as economies that broadly function according to market principles. However, in most countries, the State's ownership of productive assets has been reduced to such an extent that it is realistic to expect the private sector to provide the main spur to future growth. Within the space of a decade, a private sector has been created in which the profit motive can be expected to drive most investment decisions. This has been a major achievement, although controversy still surrounds the way in which it was achieved in several countries and the inequity that accompanied privileged groups gaining control of assets, in particular in the natural resource field, at prices that many considered considerably below their market value.

IV. Foreign direct investment

17. Policies to promote the growth of the private sector have been a major factor in attracting FDI to the economies in transition. FDI has come in either to purchase all or some of a privatized enterprise, to invest in the expansion of an existing private enterprise or to set up a completely new enterprise.

18. FDI flows have contributed to the integration of these economies into the world economy. The United Nations Conference on Trade and Development has noted how FDI was becoming an essential link between national economies, as well as a catalyst for the growth of domestic investment and enterprise competitiveness.[7] The Economic Commission for Europe has pointed out that the importance of FDI is seen to be not only in providing finance for the acquisition of new plants and equipment, but also in transferring technology and organizational forms from relatively more technologically advanced economies.[8]

19. The acceleration of privatization and increased openness to foreign investment has boosted FDI inflows in several countries that had lagged behind in attracting foreign capital in the early and mid-1990s. For example, by the end of 1996, Bulgaria had attracted less than $500 million in FDI, or about $55 per capita, in large part because of macroeconomic problems, such as high inflation and the slow progress of reform, including a sluggish privatization process. The Government that came to power in the wake of the crisis of 1996-1997 accelerated privatization. The introduction of the currency board in 1997 helped to stabilize prices, which, combined with the privatization of large enterprises in the chemical, petrochemical, and metallurgic sectors as well as banks, brought about a surge in cumulative FDI to $4 billion by the end of 2001.[9]

20. Slovakia is another economy in transition that had attracted little FDI until the late 1990s, largely because of its privatization policy which was deemed unfriendly to foreign investors. At the end of 1997, cumulative FDI in Slovakia amounted to $1.65 billion, or slightly more than $300 per capita, lagging far behind Hungary and the Czech Republic.[9] The Government that took office in 1998 recognized the advantages of foreign investment in terms of inflows of capital and know-how and it

depoliticized the privatization process. Cumulative FDI reached $6.3 billion by the end of 2001.

21. Some countries introduce specific incentives to attract investment. The Czech Republic, Romania and Slovakia introduced tax discounts for investment projects that exceeded certain thresholds in order to attract large-scale investment. Their aim was to give a boost to domestic suppliers and encourage a transfer of technology. In the Czech Republic and Slovakia, the introduction of these policies in 1997 and 1998, respectively, led to a more than doubling of their non-privatization FDI. Poland and Hungary established special economic zones with tax breaks and customs duty exemptions in order to attract investment to specific geographical areas. Other non-tax related incentives used by economies in transition include employment subsidies (paying for retraining costs) and infrastructural and project site support.

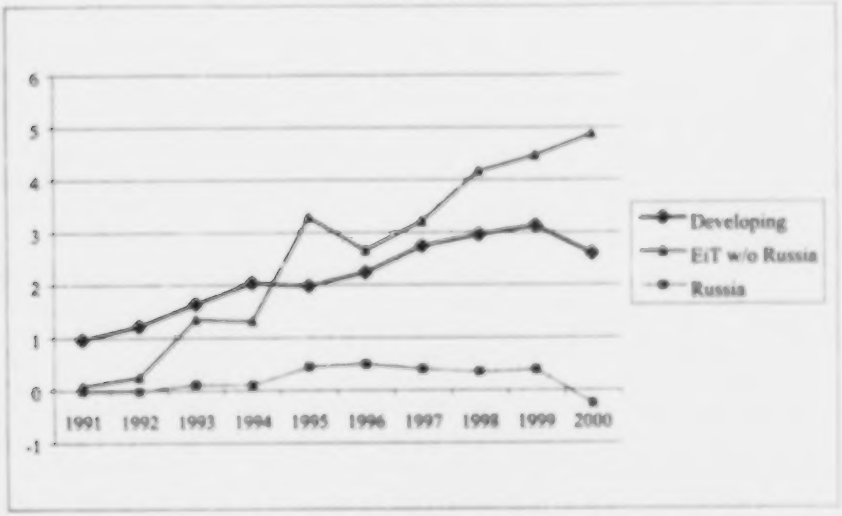
22. The success of the economies in transition in attracting FDI can be judged by comparing figures for their net inflows as a percentage of GDP with comparable figures for the developing countries. FDI flowing into the Russian Federation is shown separately from that flowing into the other economies in transition since it followed a very different pattern. In the other countries, FDI rose from virtually nothing before the transition to almost 5 per cent of GDP in 2000 (see fig. 1). Since 1995, FDI as a share of GDP in the economies in transition has been consistently greater than the share in the developing countries.

23. The Baltic countries as a group attracted more FDI as a percentage of GDP than did the countries of Central and Eastern Europe. FDI amounted to more than 5 per cent of GDP in Estonia and Latvia and to more than 3.5 per cent in Lithuania. In Central and Eastern Europe, only the Czech Republic and Hungary surpassed the 5 per cent threshold.

24. In the Baltic countries and those of Central and Eastern Europe, FDI has been driven mainly by low costs of production, proximity to the European Union and improvements in the business climate. These countries tended to receive larger amounts of FDI per head of the population than did the members of CIS (see fig. 2). The Czech Republic received over $2,000 per capita in the period 1993-2000; Hungary and Estonia received over $1,800 and $1,500, respectively. Kazakhstan and Azerbaijan were the leaders within the CIS group by this measure, receiving about $530 and $490 of FDI, respectively.

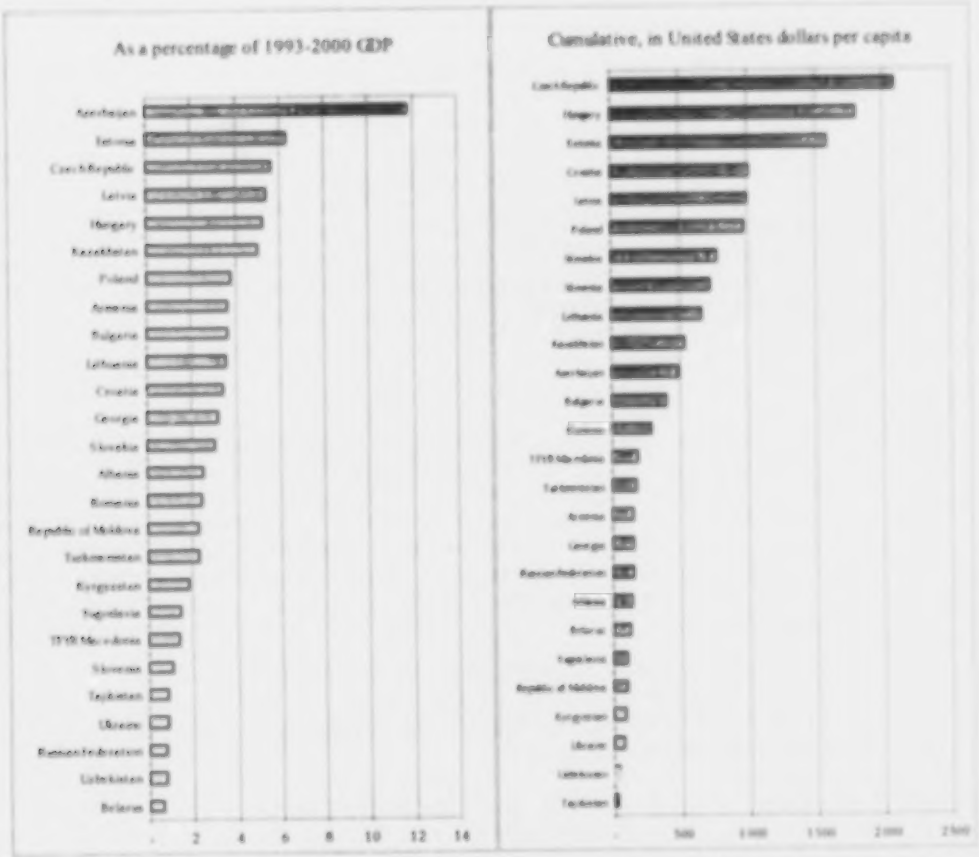
25. The CIS countries attracted FDI to develop their abundant natural resources. Azerbaijan received the largest amount of FDI in relation to its GDP: almost 12 per cent over the period 1993-2000. Turkmenistan and Kazakhstan also rank high on this measure. The low figures for some CIS countries for both FDI per capita and as a percentage of GDP show that there is still considerable progress to be made before they will attract the FDI that their potential justifies.

Figure 1
Economies in transition: ratio of net foreign direct investment to gross domestic product
(Percentage)



Source: United Nations Conference on Trade and Development, *World Investment Report 2001: Promoting Linkages* (United Nations publication, Sales No. E.01.II.D.12); World Bank, *Global Development Finance* (Washington, D.C.), analysis and summary tables, 1991-2002; and International Monetary Fund, *Balance of Payments Statistics* and *International Financial Statistics* (Washington, D.C.).

Figure 2
Economies in transition: foreign direct investment inflows 1993-2000, by country



Source: United Nations Conference on Trade and Development, *World Investment Report 2001: Promoting Linkages* (United Nations publication, Sales No. E.01.II.D.12); Economic Commission for Europe, *Economic Survey of Europe 2002 No. 1* (United Nations publication, Sales No. E.02.II.E.7); and World Bank, *World Development Indicators 2002* (Washington, D.C.).

26. Foreign investment and ownership in financial institutions help to bring foreign investment to other sectors and facilitate foreign trade. The massive inflow of foreign capital to the banking sectors of many Central and Eastern European and Baltic countries has played a major role in the rapid integration of those countries in the world economy. In Estonia, foreign banks now control over 95 per cent of all commercial bank assets. In Hungary and Poland, these percentages have reached 75 per cent and 70 per cent, respectively.[9]

27. Other financial institutions, like stock exchanges, have also attracted foreign participation or been linked to foreign exchanges, facilitating integration. The

Estonian stock exchange was recently connected with the Helsinki stock exchange's trading system. In May 2001, a majority stake in the Tallin bourse was acquired by the owner of the Helsinki stock exchange. This is expected to enhance the visibility of Estonian companies and make their shares more liquid.

28. Foreign ownership of enterprises has been seen to be beneficial with, for instance, companies controlled by foreign investors now leading the economic recoveries in both the Czech Republic and Slovakia, boosting production and exports, while at the same time often providing their employees with higher-than-average salaries. Foreign ownership of land has proved less popular, and restrictions on the foreign ownership of land is one of the issues under discussion in the negotiations for the admission of Central and Eastern European countries to the European Union. Many of those countries are concerned that the abolition of these restrictions will result in massive purchases of their land by foreigners, which those countries consider undesirable.

V. Debt

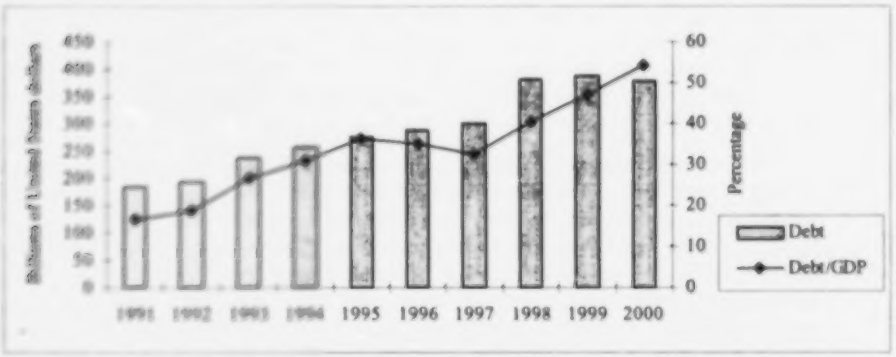
29. Countries with considerable economic potential but lacking the domestic capital to invest may be able to borrow externally to finance capacity expansion. The new productive capacity should, in turn, enable this debt to be repaid. The private and official external debt of the economies in transition increased from less than 20 per cent of GDP in 1991 to over 50 per cent in 2000 (see fig. 3). In 2000, the total debt of the region amounted to $377 billion, which was about 3 per cent less than in 1999. This was the first decrease in the total amount of debt since the transition started.

30. For many economies in transition, the debt levels are sustainable. For others, though, the situation is more difficult (see fig. 4). In Kyrgyzstan, the Federal Republic of Yugoslavia, Tajikistan and the Republic of Moldova, external debt to GDP ratios exceeded 100 per cent.

Figure 3

Economies in transition: total external debt

(Billions of dollars and percentage of gross domestic product)

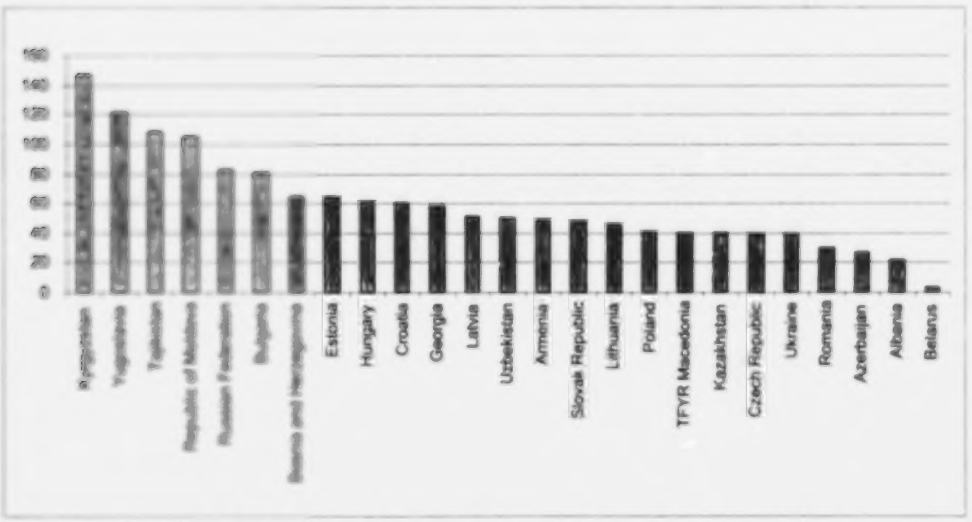


Source: World Bank, *Global Development Finance 2002*, analysis and summary tables, and *World Development Indicators 2002* (Washington, D.C.).

Figure 4

Economies in transition: ratio of total external debt to gross domestic product, 2000

(Percentage)



Note: Slovenia and Turkmenistan are excluded owing to lack of data.

Source: World Bank, *Global Development Finance 2002* and *World Development Indicators 2002* (Washington, D.C.).

VI. Integration through trade

31. Trade liberalization, as one of the components of the conversion to a market economy, started in Central and Eastern European countries much earlier than in CIS countries and, in general, was completed quickly. For small Central and Eastern European economies, such as the Czech Republic or Hungary, liberalization of trade was crucial for the development of the private sector and to attract foreign investment. It was also promoted very strongly by the European Union. Most trade restrictions in CIS countries have also now been dropped.

32. In the first stages of transition, countries benefited from the competitive prices of their exports on the global market and did not encounter strong competition from imports in their domestic markets. Subsequently, in some, mostly CIS, countries, import restrictions were imposed when current account deficits increased. However, such setbacks to trade liberalization did not change the overall picture, since international commitments entered into by the economies in transition, such as agreements signed with the European Union and the World Trade Organization (WTO) (see table 5) and such intraregional agreements as the Central European Free Trade Agreement (CEFTA), facilitated the liberalization of trade. Regulations governing foreign trade and exchange in many Central and Eastern European countries are now comparable to those of developed market economies, but some CIS countries are lagging behind.

Table 5
International commitments of economies in transition, 2001

	Membership of General Agreement on Tariffs and Trade or World Trade Organization	*European Union association agreement*
Central and Eastern European and Baltic countries		
European Union accession countries		
Bulgaria	December 1996	March 1993
Czech Republic	January 1995	October 1993
Estonia	November 1999	June 1995
Hungary	January 1995	December 1991
Latvia	February 1999	June 1995
Lithuania	May 2001	June 1995
Poland	July 1995	December 1991
Romania	January 1995	February 1993
Slovak Republic	January 1995	October 1993
Slovenia	July 1995	June 1996

	Membership of General Agreement on Tariffs and Trade or World Trade Organization	*European Union association agreement*
Others		
Albania	September 2000	
Bosnia and Herzegovina	Negotiating	
Croatia	November 2000	
Yugoslavia	Negotiating	
The former Yugoslav Republic of Macedonia	Negotiating	
Commonwealth of Independent States		
Armenia	Negotiating	
Azerbaijan	Negotiating	
Belarus	Negotiating	
Georgia	June 2000	
Kazakhstan	Negotiating	
Kyrgyzstan	December 1998	
Republic of Moldova	July 2001	
Russian Federation	Negotiating	
Tajikistan	Negotiating	
Turkmenistan	Not negotiating	
Ukraine	Negotiating	
Uzbekistan	Negotiating	

Source: European Bank for Reconstruction and Development, *Transition Report Update 2001* (London, 2001), and World Trade Organization web site, www.wto.org.
Note: Negotiating = negotiating membership of the World Trade Organization.

33. In parallel with trade liberalization, for most of the economies in transition, exports have grown in real terms and the share of exports in GDP has increased. The direction of foreign trade also changed. The Central and Eastern European and Baltic countries strongly reoriented their trade towards the developed market economies, primarily the European Union. Owing to their geographical proximity and ongoing economic and political integration, the European Union became their major trading partner and the destination for about 70 per cent of their exports. Thus, after a decade of transition, the Central and Eastern European and Baltic economies are firmly established in the European Union market, accounting in 2001 for almost 10 per cent of its imports from outside the region. At the same time,

intraregional trade, which collapsed at the beginning of the 1990s, is gradually picking up. Exports to CIS countries also increased until 1996, but weakened after the Russian crisis. Yet exports to CIS countries represent only a small fraction of total exports in many Central and Eastern European countries: in 2000, the share of the Russian Federation in total Czech and Hungarian exports was 1.3 per cent and 1.6 per cent, respectively.

34. The export success of the Central and Eastern European and Baltic countries is explained by the large inflows of export-oriented foreign investment, attracted by the favourable prospects of accession to the European Union, combined with rigorous economic reforms. Central and Eastern European industries have become increasingly integrated into international production networks, facilitating the expansion of trade and the gaining of new niches in the European Union market. The exports of the Central and Eastern European and Baltic economies prior to 1996 were in many cases limited to resource-intensive and labour-intensive products. As a result of privatization and the modernization of the economies, as well as greenfield investment, the integration of their industries into global production networks led to more capital-intensive production, increased productivity and stronger export capacity. The growing share of intra-industry trade (which is approaching two thirds of total trade) and the similarity of the trade patterns of Central and Eastern European economies to those of the European Union are strong indicators of industry-level integration.

35. The trade of CIS countries in manufactured goods, which accounted for the bulk of pre-independence trade, has yet to recover. Most manufactured goods produced in the Soviet Union were not internationally competitive and could no longer find markets, especially for the volumes manufactured under the centrally planned system. Small CIS countries that lack significant hydrocarbon resources are encountering difficulties in finding foreign markets for their products. Exports of commodities, especially crude oil, non-ferrous and precious metals and cotton have gained in importance. Most of the investment in these economies remains heavily concentrated on the production of these commodities and on facilitating their sale. These exports are generally shipped beyond CIS borders. Intermediate industrial goods, such as chemicals and wood, account for a large portion of the exports that continue to go to CIS markets.

36. Attempts to promote intra-CIS trade have not had tangible results so far, although a number of custom unions and intraregional organizations have been created. As a result of virtually stagnant exports within CIS and rapidly growing exports to the rest of the world, the share of exports to non-CIS countries in overall CIS exports surged from 27 per cent in 1991 to 80 per cent in 2000. However, total CIS exports in 2000 were only 64 per cent of their 1991 level.[10]

VII. Trade agreements and assistance

37. The association agreements signed between 1991 and 1996 by the economies in transition that are currently negotiating entry to the European Union[11] provided a framework for the gradual elimination of tariffs. Croatia and the former Yugoslav Republic of Macedonia signed the European Union Stabilization and Association Agreement in 2001. Bulgaria, the Czech Republic, Hungary, Poland, Romania,

Slovakia, and Slovenia are members of CEFTA, established in 1993. Fifteen economies in transition are now members of WTO.

38. Upon admission to the European Union, each applicant has to accept the Union's acquis communautaire. Several chapters of the acquis are directly relevant to external trade. All applicants provisionally closed the chapter on the customs union. As at 28 June 2002, the chapters on the free movement of goods, services and capital have been provisionally closed by all candidates, excluding Romania. Upon admission, trade between the current applicants and the members of the European Union will be free of barriers: that is, the few restrictions still existing will be eliminated. At the same time, the new members will have to apply European Union rules to their trade with countries outside the Union.

39. In addition to WTO, CEFTA and European Union agreements, other treaties are expected to play a role in facilitating trade. At the initiative of the European Union, the Stability Pact for South Eastern Europe was adopted in 1999 to strengthen cooperation in south-eastern Europe and to support the region's European integration. The Pact as a whole will assist the integration of these countries into the world economy. Moreover, at least two areas of cooperation and assistance within the framework of the Pact have a direct impact on the region's trade and investment. First, the memorandum of understanding on trade liberalization and facilitation, signed in 2001, assumes the completion of the system of free trade agreements in the region by the end of 2002. Second, the Investment Compact, also adopted in 2001, provides a forum aimed at the improvement of the investment climate.

40. In general, agriculture has presented considerable difficulties for trade liberalization. Although trade barriers have been lifted within CEFTA for most industrial goods, liberalization of trade in agriculture has been limited. The Czech Republic, Hungary and Slovakia signed an agreement that came into effect on 1 January 2002 and is aimed at the continued liberalization of trade in agricultural products. (The European Union also has a highly protected agricultural market, which makes it more difficult for these countries to penetrate.)

41. The CIS countries are also moving ahead in regional integration. They signed multilateral agreements on free trade within CIS in the early 1990s. However, the interpretation of these agreements varies by country. Some CIS members prefer bilateral agreements for free trade.

42. In 1996, several CIS countries created a customs union, which was subsequently transformed into the Eurasian Economic Community. The members of the Community are Belarus, Kazakhstan, Kyrgyzstan, the Russian Federation and Tajikistan. In addition to establishing a free trade regime, the members are supposed to harmonize their external tariff policies.

43. International donor organizations are providing support to economies in transition, including in enhancing their external trade capabilities. For example, the World Bank's project on trade and transport facilitation in south-east Europe (costed at about $80 million) covers seven countries. Similar assistance to the Republic of Moldova is in the pipeline. Also in the pipeline is a $100 million customs development project for the Russian Federation.

VIII. Special challenges for smaller member countries of the Commonwealth of Independent States

44. The present review of the progress made in the integration of the economies in transition into the world economy has pointed to the differences between the Central and Eastern European and Baltic countries and the CIS countries, and shown how CIS countries are lagging behind. The European Bank for Reconstruction and Development has stated that, in contrast to the Central and Eastern European and Baltic countries and the countries of south-eastern Europe which are steadily integrating their economies into the international economy, the CIS economies remain relatively isolated.[6] The International Monetary Fund and the World Bank describe how, with independence, the seven low-income CIS countries[12] have become increasingly insular, and that efforts to diversify or promote trade, for example access to the markets of the Organisation for Economic Cooperation and Development or to WTO membership, have brought mixed results.[13]

45. In arriving at an assessment of the progress of integration of the CIS countries into the world economy, some of the special challenges that most of them have faced should be taken into account. One such challenge has been their geographical location, since they are far from the three major markets in the world — Japan, the United States of America and Western Europe — and some are landlocked.[14] They were also more severely affected by the socio-economic shocks related to the beginning of transition than were the countries of Central and Eastern Europe. The break-up of the Council for Mutual Economic Assistance left the CIS economies without reliable trade partners. Unlike the countries of Central and Eastern Europe, they could not easily reorient their trade towards Western Europe. Independence also meant the loss of fiscal and financial transfers from the central Government of the Union of Soviet Socialist Republics.

46. Two economies in transition, Kyrgyzstan and the Republic of Moldova, could be eligible for treatment under the International Monetary Fund's Highly Indebted Poor Countries (HIPC) initiative. Kyrgyzstan appears to be eligible on the basis of the data for 2000 since its ratio of debt (in net present value) to exports, computed as a hypothetical stock of debt after the application of the Naples terms, reaches 169 per cent, which is above the HIPC threshold of 150 per cent.[15] The Republic of Moldova, on the other hand, could be eligible under the fiscal window since its ratio of debt (in net present value) to central government revenue, at 284 per cent, exceeds the threshold of 250 per cent.

47. In April 2002, the International Monetary Fund, the World Bank, the Asian Development Bank and the European Bank for Reconstruction and Development announced an initiative to reduce poverty, promote growth and sustainable debt levels in the seven low-income CIS countries. This initiative recognizes that rapid growth in external indebtedness threatens to undermine the economic recovery in these countries, most of which are landlocked and have poor natural endowments and therefore faced particularly difficult initial conditions after the break-up of the Soviet Union. A massive terms-of-trade shock for the net energy importing countries that resulted from the increase in energy prices to world levels after the dissolution of the Soviet Union led to the accumulation of external debt as Governments, fearing social upheaval, did not impose hard budget constraints on enterprises. At the same time, substantial fiscal subsidies from the Soviet Union were lost.

IX. Conclusion

48. **For over a decade, and often in difficult circumstances, the economies in transition have made considerable progress in integrating into the global economy. For many of them, especially the applicants to the European Union, the transition has advanced substantially. In 2001, the European Commission concluded that eight of the countries of Central and Eastern Europe (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia) were functioning market economies which could, in the short term, withstand the pressure of competition and market forces within the European Union.[16] However, in many other economies in transition, especially in some CIS countries, progress in constructing a functioning market economy and in achieving sustainable growth has been more difficult.**

49. **International assistance to the economies in transition can be viewed as an investment in helping to release the considerable resources — human, technological and natural — that had previously been underexploited. The further integration of these countries into the world economy should bring benefits not only to their citizens but also to their present and potential trading partners. For countries which are emerging from conflict, international assistance is especially important in setting them firmly on the path of peaceful development and of building up mutually beneficial economic ties with their neighbours.**

Notes

[1] For a comprehensive analysis of the transition, see the biannual *Economic Survey of Europe*, issued by the Economic Commission for Europe. The most recent *is Economic Survey of Europe 2002 No. 1* (United Nations publication, Sales No. E.02.II.E.7).

[2] Albania, Bosnia and Herzegovina, Bulgaria, the Federal Republic of Yugoslavia, the former Yugoslav Republic of Macedonia and Romania.

[3] For data on other indicators of economic performance in the transition economies, see *World Economic and Social Survey 2002* (United Nations publication, Sales No. E.02.II.C.1).

[4] European Bank for Reconstruction and Development, *Transition Report Update 1999* (London 1999).

[5] Ibid., *Transition Report 1997: Enterprise Performance and Growth* (London, 1997).

[6] Ibid., *Transition Report Update 2001* (London, 2001).

[7] *World Investment Report 2001: Promoting Linkages* (United Nations publication, Sales No. E.01.II.D.12).

[8] *Economic Survey of Europe 2001 No. 1* (United Nations publication, Sales No. E.01.II.E.14).

[9] *Review and Outlook for Eastern Europe* (PlanEcon, Inc., Washington, D.C., December 2001).

[10] Interstate Statistical Committee of the Commonwealth of Independent States, *10 Years of the Commonwealth of Independent States (1991-2000)* (Moscow, 2001).

[11] Bulgaria, the Czech Republic, Hungary, Poland, Romania, Slovakia, Slovenia and the three Baltic States.

[12] Armenia, Azerbaijan, Georgia, Kyrgyzstan, the Republic of Moldova, Tajikistan and Uzbekistan.

[13] International Monetary Fund and World Bank, "Poverty reduction, growth and debt sustainability in low-income CIS countries", 4 February 2002. On the Fund's web site at http://www.imf.org/external/np/eu2/2002/edebt/eng.

[14] For a discussion of the challenge to small, landlocked transition economies, see *World Economic and Social Survey 2001* (United Nations publication, Sales No. E.01.II.C.1), chap. VI.

[15] International Monetary Fund and World Bank, op. cit.

[16] "Enlargement strategy and report on progress made by candidate countries — year 2001", at http://www.europa.eu.int/scadplus, "Summaries of the Union's legislation".